



DEPARTMENT OF HEALTH & HUMAN SERVICES

Centers for Medicare & Medicaid Services

Administrator

Washington, DC 20201

FEB 6 2006

S. Kimberly Belshé
Secretary
Health and Human Services Agency
State of California
1600 Ninth Street
Sacramento, California 95814

Dear Secretary Belshé:

Thank you and your staff for the time spent over these past several months in discussions regarding the implementation of the Medicare Modernization Act of 2003 (MMA) and the Part D program. Most recently, your staff participated in the development of the Section 402 Demonstration Application Template for Reimbursement of State Costs for Provision of Part D Drugs which was released last week. I am pleased that states are already applying for the Demonstration.

Throughout the discussions and requests for data regarding the state's net savings as a result of MMA, it has been our impression that California has consistently underestimated its savings in both the short-term and long-term. Moreover, California's recent request to be repaid the difference between what Part D and what Medi-Cal pays in the current discussions about the transition period to Part D certainly implies that the state would have spent more on behalf of dual eligibles than what Medicare plans will spend.

As the President's Budget for 2007 is officially released today, I am able to fully respond to your letter of December 14, 2005 in which you raised questions about the estimated savings to the state through federal assumption of prescription drugs which is then partially offset through the phased-down state contribution.

Over the course of last year, our staffs had a number of occasions to discuss the state's estimated spending and savings and your requests to use alternative accounting method for rebates. The state estimated the requested adjustment would "drop California's phased-down costs by \$37.1 million." You also requested an adjustment to the baseline to "recognize the significant Medicaid prescription drug cost containment we implemented in September 2004." According to your letter, California's growth rate for calculating the state contribution should be 24.66 percent rather than the federal projected growth rate of 35.54 percent.

I am pleased to inform you that the newly-updated National Health Expenditures (NHE) growth rate to be used for the calculation of the state contribution in the President's Budget is even lower than California's index. Nationally, the state contributions will be reduced by \$37 billion in the period 2006-2015 compared to these costs estimated last summer in the Mid Session Review. In addition, we will apply the new index to

recalculate the per capita amount used in the state contribution for CY 2006. California's new per capita amount will be \$89.02 for the January-September period compared to the old amount of \$98.54, a reduction of 9.7 percent.

According to our estimates, when comparing annual payments based on December actual enrollment reported by California, using the new (NHE) will mean additional savings of \$113 million for the state in CY 2006. These savings are significantly larger than you have requested based on your own estimates.

In November, your staff provided data that estimated the State General Fund cost of drug expenditures for 1,021,000 dual eligibles in 2006 at \$1,158,368,500. In CY 2006, the state will make only 11 payments for the state contribution. Even at the old per capita amount, California would have saved \$52 million in CY 2006 ($1,021,000 \times \98.54×11 months equals \$1,106,702,740) which is worth even more than the change to accrual methodology that you requested. Applying the new per capita amount to California's data, the state will save \$158,584,880 ($1,021,000 \times \89.02×11 months equals \$999,783,620).

We had previously estimated California's drug spending for duals in 2006 would have been higher than state estimates resulting in even greater savings to the state, but applying California's own data, there is no reason to doubt the state will spend less with the state contribution than it would have if California had continued full coverage of the duals under Medi-Cal.

While California has reported it has spent \$18 million (including administrative costs) as of February 3 for the transition period to Part D, our Demonstration would reimburse the state for what it has spent. It is unclear to us, based on the guidance provided to pharmacists, whether California is being billed for the \$1 or \$3 Medicare copayment or whether they have been collected at the pharmacy. What is clear is that state would recoup nearly all of the \$18 million it has spent should the state choose to participate.

While economists and analysts can reasonably adopt different sets of assumptions and estimates are constantly updated to reflect better and more current data, we are pleased that even using California's own data, the new growth rate will get savings that exceed your expectations.

Sincerely,

A handwritten signature in black ink, appearing to read "Mark McClellan", with a long, sweeping horizontal line extending to the right.

Mark McClellan, MD, PhD

| Revised Clawback Comparisons | | | |
|------------------------------|---------------------------------------|---------------------------------------|------------------|
| A | B | C | D |
| States | Annual Payments | Annual Payments | |
| | Old NHE w/ December Actual Enrollment | New NHE w/ December Actual Enrollment | Difference (C-B) |
| Alaska | \$ 19,040,841 | \$ 17,202,153 | \$ (1,838,687) |
| Alabama | \$ 65,599,530 | \$ 59,264,881 | \$ (6,334,648) |
| Arkansas | \$ 33,815,887 | \$ 30,550,440 | \$ (3,265,447) |
| Arizona | \$ 57,615,285 | \$ 52,051,639 | \$ (5,563,646) |
| California | \$ 1,172,151,995 | \$ 1,058,962,604 | \$ (113,189,391) |
| Colorado | \$ 72,876,673 | \$ 65,839,304 | \$ (7,037,369) |
| Connecticut | \$ 124,059,021 | \$ 112,079,205 | \$ (11,979,816) |
| District of Col. | \$ 10,975,558 | \$ 9,915,699 | \$ (1,059,860) |
| Delaware | \$ 14,025,128 | \$ 12,670,785 | \$ (1,354,343) |
| Florida | \$ 479,984,275 | \$ 433,634,375 | \$ (46,349,900) |
| Georgia | \$ 130,993,456 | \$ 118,344,013 | \$ (12,649,443) |
| Hawaii | \$ 22,175,070 | \$ 20,033,724 | \$ (2,141,346) |
| Iowa | \$ 66,174,915 | \$ 59,784,704 | \$ (6,390,211) |
| Idaho | \$ 18,060,946 | \$ 16,316,883 | \$ (1,744,063) |
| Illinois | \$ 333,221,963 | \$ 301,044,232 | \$ (32,177,731) |
| Indiana | \$ 99,283,770 | \$ 89,696,387 | \$ (9,587,382) |
| Kansas | \$ 48,756,251 | \$ 44,048,082 | \$ (4,708,170) |
| Kentucky | \$ 81,122,635 | \$ 73,288,990 | \$ (7,833,644) |
| Louisiana | \$ 82,793,438 | \$ 74,798,452 | \$ (7,994,986) |
| Massachusetts | \$ 239,970,806 | \$ 216,797,916 | \$ (23,172,890) |
| Maryland | \$ 92,240,710 | \$ 83,333,444 | \$ (8,907,266) |
| Maine | \$ 45,260,376 | \$ 40,889,787 | \$ (4,370,589) |
| Michigan | \$ 188,540,434 | \$ 170,333,941 | \$ (18,206,493) |
| Minnesota | \$ 109,733,219 | \$ 99,136,780 | \$ (10,596,438) |
| Missouri | \$ 191,708,376 | \$ 173,195,969 | \$ (18,512,407) |
| Mississippi | \$ 76,553,279 | \$ 69,160,877 | \$ (7,392,402) |
| Montana | \$ 12,238,192 | \$ 11,056,405 | \$ (1,181,787) |
| North Carolina | \$ 247,898,287 | \$ 223,959,876 | \$ (23,938,411) |
| North Dakota | \$ 5,458,968 | \$ 4,931,821 | \$ (527,148) |
| Nebraska | \$ 41,619,392 | \$ 37,600,396 | \$ (4,018,996) |
| New Hampshire | \$ 30,585,921 | \$ 27,632,378 | \$ (2,953,543) |
| New Jersey | \$ 271,291,722 | \$ 245,094,314 | \$ (26,197,409) |
| New Mexico | \$ 18,845,259 | \$ 17,025,458 | \$ (1,819,801) |
| Nevada | \$ 22,496,284 | \$ 20,323,920 | \$ (2,172,364) |
| New York | \$ 779,819,148 | \$ 704,515,557 | \$ (75,303,591) |
| Ohio | \$ 230,584,176 | \$ 208,317,710 | \$ (22,266,466) |
| Oklahoma | \$ 55,382,475 | \$ 50,034,441 | \$ (5,348,034) |
| Oregon | \$ 63,234,635 | \$ 57,128,354 | \$ (6,106,281) |
| Pennsylvania | \$ 399,667,987 | \$ 361,073,866 | \$ (38,594,121) |
| Rhode Island | \$ 41,678,993 | \$ 37,654,242 | \$ (4,024,751) |
| South Carolina | \$ 77,385,665 | \$ 69,912,883 | \$ (7,472,782) |
| South Dakota | \$ 12,956,089 | \$ 11,704,978 | \$ (1,251,111) |
| Tennessee | \$ 283,931,372 | \$ 256,513,410 | \$ (27,417,962) |
| Texas | \$ 303,361,506 | \$ 274,067,264 | \$ (29,294,242) |
| Utah | \$ 21,471,442 | \$ 19,398,042 | \$ (2,073,400) |
| Virginia | \$ 166,965,498 | \$ 150,842,399 | \$ (16,123,099) |
| Vermont | \$ 18,454,617 | \$ 16,672,538 | \$ (1,782,078) |
| Washington | \$ 145,340,530 | \$ 131,305,656 | \$ (14,034,874) |
| Wisconsin | \$ 145,195,338 | \$ 131,174,484 | \$ (14,020,854) |
| West Virginia | \$ 30,780,689 | \$ 27,808,337 | \$ (2,972,351) |
| Wyoming | \$ 8,358,727 | \$ 7,551,563 | \$ (807,164) |
| Total | \$ 7,311,736,748 | \$ 6,605,675,559 | \$ (706,061,189) |
| Percent Reduction | | | -9.66% |